

Memorandum

ATTORNEY/CLIENT PRIVILEGED

To : Chief, Excise Taxes Division (MIC:56)

Date: March 16, 1999

From : Susan Y. Bennett
Tax CounselTelephone: (916) 323-7714
CalNet 473-7714Subject: **Distribution of Cigarettes to Indians in Indian Country**

This is in response to Monte William's February 4, 1999, request for clarification of the Legal Division's January 16, 1998 opinion that a "reasonable number" of unstamped cigarettes may be distributed for sale to Indians residing on a reservation. The Legal Division was specifically asked to describe what is a "reasonable number" of unstamped cigarettes. In reviewing this issue, we have concluded that, based on recent case law, a licensed distributor who sells cigarettes to an Indian residing in Indian country¹ must pay the cigarette tax, regardless of whether the cigarettes are for resale to enrolled Indians residing in Indian country.

The Legal Division's opinion of January 16, 1998, was based on the premise that a state tax is unconstitutional if its legal incidence falls on a tribe or on tribal members residing in Indian country. (See, e.g., *Bryan v. Itasca County* (1976) 426 U.S. 373, 48 L. Ed. 2d 710.) While the premise remains valid, the United States Supreme Court has held that, when the legal incidence of a state tax rests on non-Indians, no categorical bar prevents the enforcement of the tax, the balance of federal, state, and tribal interests favors the State, and federal law is not to the contrary, the State may impose its levy. (*Oklahoma Tax Com. v. Chickasaw Nation* (1995) 515 U.S. 450, 458, 132 L. Ed. 2d 400, 409-410.)

In *Chickasaw Nation, supra*, which involved a motor fuels tax, the Court noted that Oklahoma law did not specify where the legal incidence of the tax fell. The court nonetheless concluded, based on a "fair interpretation of the taxing statutes as written and applied" [*California Board of Equalization v. Chemehuevi Tribe, infra*] that, because fuel distributors remitted the amount of tax due to the Tax Commission on behalf of a licensed retailer, the tax obligation was legally the retailer's, not the distributor's. The Court described the distributor's role as merely that of a transmittal agent for the taxes imposed on the retailer. The Court observed that the motor fuels tax law did not contain any provision which allowed the retailer to pass on the tax to the consumer or place liability on the consumer for possessing untaxed fuel. (*Id.*, 515 U.S. at p. 460, 132 L. Ed. 2d at p. 411.) The Court held that Oklahoma could not require an Indian tribe (retailer) to pay the state motor fuels tax, and stated, "when Congress does not

¹The term "Indian country" is defined in Title 18, USC §1151, and includes, but is not limited to reservations.

instruct otherwise, a State's excise tax is unenforceable if its legal incidence falls on a Tribe or its members for sales made within Indian country." (*Id.*, 515 U.S. at p. 452, 132 L.Ed.2d at p. 406.) The Court stated that it was focusing on the tax's legal incidence to provide predictability to the realities of tax administration and to provide a reasonably bright-line standard as requested by the parties who had filed *amicus* briefs. (*Id.*, 515 U.S. at pp. 459-460, 132 L.Ed.2d at p. 410.) In dicta, the Court stated that "[i]f a State is unable to enforce a tax because the legal incidence of the impost is on Indians or Indian tribes, the State generally is free to amend its law to shift the tax's legal incidence." (*Id.*, 450 U.S. 459, 132 L. Ed. 2d at p. 410.)

Relative to the Cigarette and Tobacco Products Tax Law (Part 13, Division 2, Revenue and Taxation Code, commencing with Section 30001)², the incidence of the cigarette tax may shift, depending upon the circumstances of the transaction, including the taxability of the parties to the transaction. For example, pursuant to Sections 30101 and 30123, a distributor must pay a tax upon the distribution of cigarettes. Section 30008 defines distribution as follows:

'Distribution' includes:

- (a) The sale of untaxed cigarettes or tobacco products in this state.
- (b) The use or consumption of untaxed cigarettes or tobacco products in this state.
- (c) The placing in this state of untaxed cigarettes or tobacco products in a vending machine or in retail stock for the purpose of selling the cigarettes or tobacco products to consumers.

Pursuant to Section 30108(a), a person who makes a distribution of cigarettes with respect to which the taxes imposed by Sections 30101 and 30123 are inapplicable must collect the cigarette tax from the purchaser at the time the person is obligated to pay the tax with respect to the purchaser's distribution of the cigarettes. In that instance, the purchaser is obligated to pay the cigarette tax for the "distribution" of cigarettes which occurs as a result of the use or consumption of cigarettes. Section 30009 defines "use or consumption" as the exercise of any right or power over cigarettes incident to the ownership of the cigarettes. Hence, the legal incidence of the tax is on the purchaser, although the tax is collected by the person who made the distribution of the untaxed cigarettes to the purchaser. (*California Board of Equalization v. Chimehuevi* (1985) 474 U.S. 9, 88 L.Ed.2d 9.)

Notwithstanding Section 30108(a) which applies to a distribution in which the cigarette tax is not applicable, a non-Indian distributor who makes a distribution to Indians residing in Indian country from stock located in this state is required to pay the tax unless the transaction meets the requirements of one of the statutory exemptions in the Cigarette and Tobacco Products Tax Law. There is no exemption which relieves the non-Indian distributor from paying the cigarette tax upon the distribution of cigarettes to Indians located in Indian country. Despite the fact that the economic burden of a tax may be passed on to the purchaser, the legal

²All further references are to the Revenue and Taxation Code unless otherwise specified.

incidence of a tax has been held not to shift to the purchaser as a result of the economic burden. (See, e.g., *Gurley v. Rhodes* (1975) 421 U.S. 200, 204-205, 44 L.Ed.2d 110, 115.) Therefore, the non-Indian distributor's obligation to pay the cigarette tax upon the distribution of cigarettes to Indians in Indian country should be enforceable if the balance of federal, state, and tribal interests favors the state, and federal law is not to the contrary.

We note that there is no federal law which prohibits a state from enforcing its tax laws against a non-Indian distributor.

The United States Supreme Court made by the following observation with respect to the balancing of the State and tribal interests:

While the Tribes do have an interest in raising revenues for essential governmental programs, that interest is strongest when the revenues are derived from value generated on the reservation by activities involving the Tribes and when the taxpayer is the recipient of tribal services. The State also has a legitimate governmental interest in raising revenues, and that interest is strongest when the tax is directed at off-reservation value and when the taxpayer is the recipient of state services.

(*Washington v. Confederated Tribes* (1980) 447 U.S. 134, 156-157, 65 L.Ed.2d 10, 31.)

In *McClanahan v. Arizona State Tax Commission* (1973) 411 U.S. 164, 179, 36 L.Ed.2d 129, 140, the Court cited the case of *Williams v. Lee* (1959) 358 U.S. 217, 3 L.Ed.2d 251, in describing a test to determine whether a state's enforcement of its laws infringed on the right of reservation Indians to make their own laws and be ruled by them. In *McClanahan*, the Court observed that the *Williams* test was principally applicable in situations involving non-Indians, and stated, "[i]n these situations, both the tribe and the State could fairly claim an interest in asserting their respective jurisdictions. The *Williams* test was designed to resolve the conflict by providing that the State could protect its interest up to the point where tribal self-government would be affected." (*Id.*)

The Ninth Circuit Court of Appeals held that the legal incidence of a tax was on the lessee in a case which involved a possessory interest tax on the leasehold interest of the lessee of land owned by an Indian lessor. (*Fort Mojave Tribe v. San Bernardino County* (9th Cir. 1976) 543 F.2d 1253, 1253.) In *Fort Mojave Tribe*, the statutory scheme contained no provision which could make the lessor personally liable for any of the delinquent possessory interest taxes. The Ninth Circuit concluded that the only effect of the possessory interest tax on the Indians was the indirect one of possibly reducing the revenues the Indians would receive from the leases as a result of their inability to market a tax exemption, and that, "[s]uch an indirect economic burden cannot be said to threaten the self-governing ability of the tribe." (*Id.*, at p. 1258.)

Applying the *Williams* test and reasoning of the Ninth Circuit in *Fort Mojave Tribe, supra*, to the cigarette tax paid by distributors in this state, this state's interest in enforcing its tax law

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against the non-Indian distributor cannot be said to affect tribal self-government, even if enforcement of the tax has an indirect economic burden on the Indian retailer who intends on selling the cigarettes to enrolled Indians residing in Indian country. Therefore, based on the United States Supreme Court's focus on the legal incidence of a tax in *Chickasaw Nation, supra*, it is the Legal Division's opinion that the balance of interests favors the state in enforcing the payment of the cigarette tax by a non-Indian distributor, regardless of the fact that the distributor is making a distribution of cigarettes to Indians in Indian country. This approach assures the state that the cigarette tax is applied in a fair and consistent manner. In addition, the assessment of the cigarette tax against a distributor appears to be consistent with the view of the United States Supreme Court in *Dept. of Taxation and Finance of New York v. Milhelm Attea & Bros., Inc.* (1994) 512 U.S. 61, 72, 129 L.Ed.2d 52, 63, where the Court stated that, "States may of course collect the sales tax from cigarette wholesalers, either by seizing unstamped cigarettes off the reservation, [*Washington v. Confederated Tribes of Colville Reservation* (1980) 447 U.S. 134, 161-162, 65 L.Ed.2d 10, 34], or by assessing wholesalers who supplied unstamped cigarettes to the tribal stores." (Quoting *Oklahoma Tax Comm'n. v. Citizen Band of Potawatomi Tribe of Okla.* (1991) 498 U.S. 505, 514, 112 L.Ed.2d 1112, 1123.)

If you have any questions, please feel free to contact me at the telephone number provided above.

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